

Internal Revenue Service

Department of the Treasury

Index No.: 409.01-00

Washington, DC 20224

199916055

Person to Contact:

Telephone Number:

Refer Reply to:
OP:E:EP:T:1

Date:

JAN 27 1999

• Legend:

Company A:

Company B:

Company C:

Partnership D:

State E:

Dear :

This is in response to a letter ruling request dated October 8, 1997, as supplemented by a facsimile dated January 19, 1999, for a ruling under section 409(l) of the Internal Revenue Code (the "Code") submitted on your behalf by your authorized representative. The following facts and representations were submitted in connection with your ruling request:

Company A is a closely-held corporation which established an employee stock ownership plan on July 8, 1996 (the "ESOP") for its employees. The ESOP is a plan intended to be qualified under sections 401(a) and 4975(e)(7) of the Code. Company A has two classes of stock outstanding, Class A common stock and Class B common stock, neither of which is readily tradable on an established securities market. Class A and Class B have identical voting and dividend rights except that Class B shares must be voted in the same proportion as Class A shares. The ESOP holds 100 percent of Class A shares, while the management of Company A owns 100 percent of Class B shares. As of September 30, 1998, this represented 40 percent ownership of the number of shares outstanding by the ESOP (including both allocated and unallocated shares) and 60 percent ownership of outstanding shares by management.

317

1999-8055

Company A underwent a corporate restructuring as of October 1, 1997, by forming two wholly owned subsidiaries, Company B and Company C, through a transfer of assets and cash. Company B and Company C in turn formed Partnership D, a limited partnership under the laws of State E, with Company B a one percent general partner and Company C a 99 percent limited partner. Upon its formation, Partnership D elected to be classified as an association taxable as a corporation under section 301.7701-3 of the Treasury Regulations (the "regulations"), effective on September 29, 1997 (the date of its creation). Under the terms of the ESOP, an entity making this election may become an employer thereunder and the employees of such employer may participate in the ESOP.

Based on the above facts and representations, you request a ruling that under section 409(l)(4) of the Code, the employees of Partnership D will be able to participate in the ESOP established by Company A as a result of being a member of a controlled group of corporations under section 1563(a), by virtue of being treated as a corporation under section 301.7701-3(a) of the regulations.

Section 4975(e)(7) of the Code defines an ESOP as a defined contribution plan which is a stock bonus plan qualified under section 401(a), and which is designed to invest primarily in qualifying employer securities. Section 4975(e)(8) defines the term "qualifying employer security" as any employer security within the meaning of section 409(l).

Under section 409(l)(1) of the Code, the term "employer securities" means common stock issued by the employer (or member of the same controlled group) which is readily tradable on an established securities market. If there is no common stock that satisfies the requirements of section 409(l)(1), section 409(l)(2) defines "employer securities" to mean common stock issued by the employer or by a corporation which is a member of the same controlled group having the greatest voting and dividend rights.

Section 409(l)(4) of the Code defines the term "controlled group of corporations" as having the same meaning as under section 1563(a) (determined without regard to subsections (a)(4) and (e)(3)(C) of section 1563).

Under section 1563 of the Code, one or more corporations will constitute a parent-subsidiary controlled group if stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of the stock of each corporation is owned by one or more of the other corporations, and the common parent owns at least 80 percent of the total

215

combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of the stock of at least one of the other corporations.

Section 301.7701-2(b)(2) of the regulations defines a corporation as an association as determined under section 301.7701-3. Section 301.7701-2(a) provides that for purposes of sections 301.7701-2 and 301.7701-3, a business entity is an entity recognized for federal tax purposes that is not properly classified as a trust or otherwise subject to special treatment under the Code. Section 301.7701-3(a) provides that a business entity that is not classified as a corporation under sections 301.7701-2(b)(1) and 301.7701-2(b)(3) through (8), is an eligible entity, and can elect its classification for federal tax purposes. Partnership D is a state law limited partnership formed under the laws of State E, and does not meet the definition of a corporation under section 301.7701-2(b)(1) and (3) through (8). Therefore, Partnership D may elect its classification pursuant to the rules of section 301.7701-3.

Section 301.7701-3(b)(1) of the regulations provides the rules for making a classification election for domestic eligible entities. That section provides that a domestic eligible entity with two or more owners must make an election if it desires to be classified as an association taxable as a corporation.

The rules regarding the timing of making an election are set forth in section 301.7701-3(c) of the regulations. They provide that a classification election is made on Form 8832. This election must be filed within 75 days of the intended effective date of the election.

We conclude that, assuming that Partnership D filed Form 8832 within the proper time frame, and that the form was properly completed, it will be classified as an association taxable as a corporation for federal tax purposes and will be considered a member of a controlled group of corporations within the meaning of section 1563 of the Code. Company A stock does not satisfy the definition of employer securities under section 409(l)(1) since it is not readily tradable on an established securities market. Class A common stock satisfies the definition of employer securities under section 409(l)(2) since it has a combination of dividend and voting rights that are at least equal to those of Class B stock, the only other class of stock outstanding. Accordingly, Class A stock held by the ESOP constitutes "employer securities" within the meaning of Code section 409(l) with respect to employees of Partnership D. Thus, the employees of Partnership D may participate in the ESOP.

Although Partnership D is considered a member of Company A's

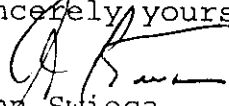
199918055

controlled group under sections 409(l)(4) and 1563, no inferences should be drawn regarding whether partnership interests can qualify as employer securities for purposes of other provisions of the Code, including sections 409(l)(1) or 409(l)(2), nor whether a partnership classified as an association taxable as a corporation is treated as a corporation for purposes other than the one described in this letter ruling.

The above ruling is based on the assumption that the ESOP is qualified under sections 401(a), 409 and 4975(e)(7), and the related trust is tax exempt under section 501(a) of the Code at all relevant times.

In accordance with a power of attorney on file in this office, a copy of this ruling is being sent to your authorized representative.

Sincerely yours,


John Swieca
Chief, Employee Plans
Technical Branch 1